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C O N F I D E N T I A L SECTION 01 OF 03 RPO DUBAI 000382

SIPDIS

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SUBJECT: IRAN: AHMADINEJAD TAKES ANOTHER RUN AT GASOLINE SUBSIDY

REFORM

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REASON: 1.4 (b), (d)

¶1. (C) SUMMARY: President Ahmadinejad has opened his second term intending to pursue gasoline subsidy reform. Although the Majlis refused to endorse the proposed reforms at the end of his first term, this time Ahmadinejad seems to have the support of Supreme Leader Khamenei, and the government is feigning flexibility by publicly offering alternatives. In reality, however, Ahmadinejad wants his politically unpopular proposal to remove subsidies and provide cash payments to targeted low-income individuals pushed through the Majlis. Gasoline subsidies are the third rail of Iranian politics, and re-introducing such a controversial program amid continuing political instability and Ahmadinejad's personal unpopularity hints at the economic reality of Iran's weaker foreign reserve and current account deficit position, and the recognition that continued massive subsidies for gasoline are not sustainable. Even with the Supreme Leader's support, the proposal will be unpopular, and knowledgeable IRPO contacts have said that any Western-led gasoline sanctions might give Ahmadinejad the cover he needs by allowing him to blame sanctions for any and all gasoline-related problems. End Summary.

PROPOSED 'SHOCK AND AWE' PACKAGE FAILED TO 'SHOCK AND AWE'

¶2. (C) Towards the end of its first term the Ahmadinejad administration pushed a 'targeted' gasoline subsidy reform bill, coupling subsidy removal with cash payments to low-income populations. The Majlis refused to endorse the bill due to questions about Ahmadinejad's political motive in an election year, the possible increase in inflation that cash payments might trigger, and the overall rushed manner in which the administration demanded that funds be allocated to execute the program. In addition, the lack of enthusiasm for reform reflected strong public support for maintaining subsidies.

¶3. (C) One journalist who interviewed Majlis members about a gasoline reform program told IRPO that the deputies widely perceived Ahmadinejad's first-term reform package as an irresponsible attempt to "shock-and-awe" the public with economic reform intended to reverse putatively elitist oil

wealth distribution, consistent with his campaign pledge to 'put Iran's oil wealth on the table of ordinary Iranians.' The reporter added that while Majlis members protested the package largely for their own political reasons, many recognized that cash handouts to sub-sections of the population identified as lower-class would add to inflation.

#### GASOLINE DOWN THE DRAIN

14. (U) While the Ahmadinejad plan to couple the end of gasoline subsidies with cash payments to the lowest nine groups of income-earners in Iran (to be determined by survey if the legislation is passed) did not find favor with legislators, most recognize the severity of the economic impact the current program creates. The current subsidy program provides Iranians a monthly 100 liter quota per personal vehicle and 300 liter quota per business vehicle at \$0.35 per gallon. This price represents one-fifth the market price and a direct cost to the government of between USD 3-6 billion a year. The gasoline subsidy program also fuels wasteful consumption (the growth in the rate of gasoline consumption is twice that of the growth in the rate of GDP) and an annual USD one billion (1.8 billion liters) smuggling operation of gasoline out of the country as well as a large internal black market for gasoline. As a result, the program hampers state revenues and indirectly erodes Iran's oil export market. In total, the program is estimated to consume 10-20 percent of GDP annually.

15. (U) Current economic data also indicates that it is becoming increasingly difficult for the government to fund the subsidy program through the Oil Stabilization Fund (OSF). An ongoing current account deficit, a projected fiscal deficit of over 13 percent (USD 42 billion) to GDP for the current year, and an

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increasingly larger budget required to support other government expenditures means the government has repeatedly raided the OSF not only to fund the gasoline subsidy program but various other government expenditures as well. Head of the Majlis Economic Commission Gholamreza Mesbahi-Moghaddam told the Mehr News Agency in March that the OSF had declined to USD 23 billion, far short of the projected USD 42 billion projected deficit for 2009/2010. The government has tried to increase state revenue recently by pumping 200,000 b/d beyond its OPEC-allocated output quota as well as by aggressively offering bonds in the domestic market. Neither action is enough to meet the large deficit gap which means the subsidy program remains an increasingly large drain on revenues.

#### THE ALTERNATIVES

16. (U) The government has announced the continuation of the subsidy program through October but also has proposed three possible options on gasoline going forward in the second half of the Persian year (October through March). The first would continue the current subsidy program. By the Ahmadinejad government's estimation, this option would require the Majlis to approve an additional USD three billion in funding. In the second scenario, reduced quotas of subsidized gasoline would force consumption down by 10 percent and require an additional USD two billion in funding. The last option would enact the proposed "targeted" subsidies and with the exception of cash payments would mean no more subsidized gasoline quotas. While the end of subsidies would best address Iran's bleak fiscal situation, it is difficult to determine where the funds for cash payments would come from or how much the administration is

looking to spend on them. On September 15, head of the State Headquarters for Management of Transportation and Fuel, General Mohammed Rouyanian tried to quell rumors that the government plans to cut the gasoline quota by half for the remainder of the year, announcing in state media, "the government has yet to take a decision."

#### KHAMENEI LIKES TARGETED SUBSIDIES

17. (C) While seemingly willing to offer alternatives, the government's intention seems to be to implement the same targeted subsidy program it introduced previously and for the new program to begin in the second half of the current Persian year. The simultaneous release of the alternative options for gasoline subsidy reform with a statement by the Supreme Leader requesting that the government complete targeted subsidies in this term is a clear indication that the government plans to press hard on the issue, as is a recent statement by Ahmadinejad that he will seek passage of his subsidies bill at the start of Mehr month (September 22). In a speech to the new cabinet on September 7, Supreme Leader Khamenei said, "Currently the government is paying fewer subsidies to the poor and paying more to the wealthy. Making the subsidies targeted, which has been mentioned, is truly an important measure." He then complained that previous governments failed to enact such reforms and instructed the new cabinet to act, saying "Now, those governments have gone but you have to pursue such a thing."

#### COMMENT

18. (C) The government has wanted to eliminate the gasoline subsidy for years, the logic goes, because it is a large drain on revenues and encourages waste, but has feared the public backlash that would result. In assessing the repercussions of Western gasoline sanctions against Iran, the strong consensus among informed IRPO contacts is that that gasoline sanctions would help Ahmadinejad politically, giving his administration the political cover it needs to eliminate subsidies and allowing the government to blame higher prices and less supply on the United States, while at the same time putting the country on a stronger financial footing. It would also help to strengthen

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the IRIG financially by giving them another profitable source of black market profits. END COMMENT.  
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